

**Updated Informative Digest for the State Board of Equalization's
Adoption of Proposed Amendments to California Code of Regulations,
Title 18, Section 1655, *Returns, Defects and Replacements***

The State Board of Equalization (Board) held a public hearing regarding the proposed amendments to California Code of Regulations, title 18, section (Regulation) 1655, *Returns, Defects and Replacements*, on April 22, 2014. During the public hearing, the Board unanimously voted to adopt the proposed amendments to Regulation 1655 without making any changes.

The Board did not receive any written comments regarding the proposed regulatory action and no interested parties appeared at the public hearing on April 22, 2014, to comment on the proposed regulatory action. There have not been any changes to the applicable laws or the effect of, the objective of, and anticipated benefits from the adoption of the proposed amendments to Regulation 1655 described in the informative digest included in the notice of proposed regulatory action. The informative digest included in the notice of proposed regulatory action provides:

Current Law

General

The Song-Beverly Consumer Warranty Act (commencing with Civ. Code, § 1790) contains provisions that provide warranty protections to purchasers of both new and used consumer goods. The act includes provisions (Civ. Code §§ 1793.2 - 1793.26) that require compensation to California consumers of defective new motor vehicles – provisions commonly referred to as California's "Lemon Law." The Lemon Law provides, in relevant part, that if a manufacturer or its representative in this state, such as an authorized dealer, is unable to service or repair a new motor vehicle to conform to the applicable express warranties after a reasonable number of attempts, the manufacturer is required to either promptly replace the vehicle or make restitution to the buyer. (Civ. Code, § 1793.2, subd. (d)(2).)

Under the existing Sales and Use Tax Law (Rev. & Tax. Code, § 6001 et seq.), a lease of tangible personal property, including a lease of a motor vehicle, is, with exceptions not relevant here, a "sale" and a "purchase." (Rev. & Tax. Code, §§ 6006, 6010.) For a lease that is a "sale" and a "purchase," the tax is measured by the rentals payable. However, as provided in subdivision (c)(1) of Regulation 1660, *Leases of Tangible Personal Property – In General*, the applicable tax is generally use tax, not sales tax, and the lessor is required to collect the use tax from the lessee at the time the amount of rent is paid and give him or her a receipt as prescribed in Regulation 1686, *Receipts for Tax Paid to Retailers*. The

lessee is not relieved from liability for the tax until he or she is given such a receipt or the tax is paid to the state.

The Lemon Law originally provided that in the case of restitution, a manufacturer was required to make restitution in an amount equal to the actual price paid or payable by the buyer, including, among other collateral charges, *sales* tax. (Civ. Code, § 1793.2.) The Lemon Law further required the Board to reimburse the manufacturer for an amount equal to the *sales* tax which the manufacturer paid to or for a buyer when providing a replacement vehicle or included in making restitution to the buyer when satisfactory proof was provided that the retailer of the motor vehicle for which the manufacturer was making restitution had reported and paid the sales tax on the gross receipts from the sale, and that the manufacturer had complied with the requirements of Civil Code section 1793.23, subdivision (c). However, the Lemon Law was silent with respect to whether restitution was required to include *use* tax and whether the Board was required to reimburse a manufacturer for use tax paid to or for a buyer or lessee or included in restitution paid to a buyer or lessee.

As relevant here, AB 242 amended the Lemon Law, specifically Civil Code sections 1793.2 and 1793.25, to make technical corrections sponsored by the Board. The amendments clarify that restitution, under the Lemon Law, includes *use* tax paid or payable by a buyer, including a lessee, of a new motor vehicle, and require the Board to reimburse a manufacturer of a new motor vehicle for an amount equal to the *use* tax that the manufacturer is required to pay to or for a buyer or lessee when replacing a vehicle or making restitution pursuant to the Lemon Law. And, AB 242 provides that the Board-sponsored amendments to the Lemon Law are declaratory of existing law. (AB 242, § 21.)

In the case of restitution, Civil Code section 1793.2, subdivision (d)(2)(B) now provides, in relevant part, that the manufacturer shall make restitution in an amount equal to the actual price paid or payable by the buyer, including any collateral charges “such as sales or use tax.” And, Civil Code section 1793.2, subdivision (d)(2)(D) now specifies that “Pursuant to Section 1795.4, a buyer of a new motor vehicle shall also include a lessee of a new motor vehicle.”

With respect to reimbursement, Civil Code section 1793.25, subdivision (a) now expressly requires the Board to reimburse a manufacturer of a new motor vehicle for an amount equal to “the sales tax or use tax” which the manufacturer pays to or for the buyer “or lessee” when providing a replacement vehicle or includes in making restitution to the buyer “or lessee” under the Lemon Law, and, as a condition to receiving reimbursement, requires a manufacturer to provide satisfactory proof for one of the following:

- The retailer of the motor vehicle for which the manufacturer is making restitution has reported and paid the sales tax on the gross receipts from the sale of that motor vehicle.
- The buyer of the motor vehicle had paid the use tax on the sales price for the storage, use, or other consumption of that motor vehicle in this state.
- The lessee of the motor vehicle had paid the use tax on the rentals payable from the lease of that motor vehicle.

Also, Civil Code section 1793.25, subdivision (e) now provides that “The amount of use tax that the State Board of Equalization is required to reimburse the manufacturer shall be limited to the amount of use tax the manufacturer is required to pay to or for the lessee” under the Lemon Law.

Effect, Objective, and Benefits of the Proposed Amendments to Regulation 1655

Need for Clarification

Subdivision (b)(2) of Regulation 1655 explains when manufacturers must provide restitution or a replacement vehicle to a buyer under the Lemon Law. Regulation 1655, subdivision (b)(2), also prescribes the requirements for a manufacturer to claim a refund from the Board for sales tax or sales tax reimbursement included in restitution paid to a buyer under the Lemon Law. However, Regulation 1655 does not indicate that AB 242 clarified that, under the Lemon Law, restitution includes *use* tax paid or payable by a buyer or lessee of a new motor vehicle and required the Board to reimburse a manufacturer of a new motor vehicle for an amount equal to the *use* tax that the manufacturer is required to pay to or for a buyer or lessee when replacing a vehicle or includes in making restitution to a buyer or lessee, under the Lemon Law. Therefore, the Board’s Business Taxes Committee (BTC) staff determined that amendments to Regulation 1655 are needed in order to make the regulation consistent with and implement, interpret, and make specific AB 242’s amendments to the Lemon Law set forth above.

Interested Parties Process

As a result of AB 242, BTC staff drafted amendments to Regulation 1655. Specifically, the draft amendments suggested adding language to Regulation 1655, subdivision (b)(2)(A) to incorporate the new provisions of Civil Code section 1793.2, subdivision (d)(2)(D), by specifying that, for purposes of Regulation 1655, the term buyer includes a lessee of a new motor vehicle. The draft amendments suggested adding “or use” tax to where the current regulation refers to “sales tax or sales tax

reimbursement” in subdivision (b)(2)(B) and (C). The draft amendments suggested adding “or lease” after “sales” where the current regulation refers to “sales agreement” and after “sale” where the current regulation refers to “retail sale” in subdivision (b)(2)(B). The draft amendments also suggested adding “or lessor” after “dealer” where the current regulation refers to “the buyer and the dealer” and “the seller’s permit number of the dealer” in subdivision (b)(2)(B).

In addition, the draft amendments suggested revising and reformatting the last sentence in Regulation 1655, subdivision (b)(2)(B), which currently requires a manufacturer, when filing a claim for refund for sales tax or sales tax reimbursement included in restitution paid to a buyer, to submit evidence that the dealer who made the retail sale of the non-conforming vehicle to that buyer reported and paid sales tax on the gross receipts from that sale. The revised and reformatted sentence requires a manufacturer, when filing a claim for refund for sales or use tax or sales tax reimbursement included in restitution paid to a buyer, including a lessee, under the Lemon Law, to provide “evidence of one of the following” from a list that includes proof that: (1) “The dealer had reported and paid sales tax on the gross receipts from that sale”; (2) “The buyer of the motor vehicle had paid the use tax on the sales price for the storage, use, or other consumption of that motor vehicle in this state”; or (3) The lessee of the motor vehicle has paid the use tax on the rentals payable from the lease of the vehicle.” The draft amendments also suggested adding a new subdivision (b)(2)(D) to Regulation 1655 to specify that “The amount of use tax that the Board is required to reimburse the manufacturer shall be limited to the amount of use tax the manufacturer is required to pay to or for the lessee,” as provided by Civil Code section 1793.25, subdivision (e).

BTC staff subsequently prepared a discussion paper regarding the amendments made to the Lemon Law by AB 242 and staff’s draft amendments to Regulation 1655, provided the discussion paper and its draft amendments to Regulation 1655 to the interested parties, and conducted an interested parties meeting on August 8, 2013, to discuss the draft amendments to Regulation 1655. During the interested parties meeting, a participant inquired as to how the provisions of Regulation 1655 would apply to a transaction in which a lessor paid tax at the time the lessor purchased a vehicle which the lessor would then lease. Staff considered the scenario and, subsequent to the meeting, staff explained to the participant that in the event a lessor purchases a vehicle in this state tax paid, the transaction would generally be subject to sales tax and the dealer would likely collect sales tax reimbursement from the lessor. (See Reg. 1660, subd. (c)(2) and (3), regarding property purchased tax-paid and leased in substantially the same form as acquired.) And, staff explained that, with respect to sales tax transactions, the existing provisions of

Regulation 1655 would apply to a manufacturer's claim for a refund for sales tax reimbursement the manufacturer included in restitution paid to a lessor, under the Lemon Law. Furthermore, staff noted that AB 242 did not change the application of the Lemon Law to sales tax transactions, and that questions regarding the application of Regulation 1655 to sales tax transactions were beyond the scope of the current interested parties process, which was to discuss the issue of whether to amend Regulation 1655 to clarify the new provisions of the Lemon Law applicable to use tax transactions.

Since BTC staff did not receive any other inquiries or comments regarding its draft amendments during or subsequent to the first interested parties meeting and staff had no changes to its recommendation to amend Regulation 1655, BTC staff did not prepare a second discussion paper and cancelled the second interested parties meeting that was previously scheduled to discuss staff's draft amendments. Staff also notified interested parties that comments could be submitted up to October 17, 2013, for consideration in the preparation of a Formal Issue Paper regarding the draft amendments. However, staff did not receive any other comments.

December 17, 2013, BTC Meeting

Subsequently, staff prepared Formal Issue Paper 13-012 and distributed it to the Board Members for consideration at the Board's December 17, 2013, BTC meeting. Formal Issue Paper 13-012 recommended that the Board approve and authorize publication of the amendments to Regulation 1655 (discussed above) in order to incorporate the provisions of Civil Code sections 1793.2 and 1793.25, as amended by AB 242, by:

- Specifying that the term buyer includes a lessee of a new motor vehicle (as provided in Civ. Code, § 1793.2, subd. (d)(2)(D), as added by AB 242).
- Adding a reference to use tax, lease agreement, lessor, and lease where the current regulation refers to sales tax, sales agreement, dealer, and retail sale, respectively.
- Creating a list of the types of evidence that sales or use tax was paid, and requiring a manufacturer to provide one of the listed types of evidence when filing a claim for refund (consistent with Civ. Code, § 1793.25, subd. (a), as amended by AB 242).
- Specifying that the amount of use tax that the Board is required to reimburse the manufacturer is limited to the amount of use tax the manufacturer is required to pay to or for the lessee (as provided in Civ. Code, § 1793.25, subd. (e), as added by AB 242).

During the December 17, 2013, BTC meeting, the Board Members unanimously voted to propose the amendments to Regulation 1655 recommended in the formal issue paper. The Board determined that the proposed amendments to Regulation 1655 are reasonably necessary to have the effect and accomplish the objective of making the regulation consistent with and implementing, interpreting, and making specific the amendments made to Civil Code sections 1793.2 and 1793.25, by AB 242.

The Board anticipates that the proposed amendments to Regulation 1655 will promote fairness and benefit taxpayers, including manufacturers, Board staff, and the Board by providing additional notice regarding and implementing, interpreting, and making specific the amendments made to Civil Code sections 1793.2 and 1793.25, by AB 242.

The Board has performed an evaluation of whether the proposed amendments to Regulation 1655 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations because Regulation 1655 is the only state regulation prescribing the requirements for the Board to reimburse a manufacturer under Civil Code section 1793.25. In addition, the Board has determined that there are no comparable federal regulations or statutes to Regulation 1655 or the proposed amendments to Regulation 1655.